1. FINANCIAL MANAGEMENT

1.1 INTRODUCTION

1.1.1 *Financial Management* is a process having as its primary objective the optimization of financial and economic benefits from an investment. Although viewed and managed as a process, it comprises multiple processes, including financial accounting, management (and cost) accounting, assets accounting, cash and money markets accounting, financial reporting, internal controls and internal audit, with external audit providing a report and opinion on the reported financial status and performance. Each of these processes, including financial management itself, should incorporate sub-processes and techniques, including management, forecasting, strategic planning, planning and budgeting, organizing, procurement, disbursements, control and communications.

1.1.2 This rest of this section outlines some initiatives in the area of good governance that the Bank is involved in and that have direct bearing on financial management of Bank operations.

**Combating Corruption**

1.1.3 Since it issued its Policy on Good Governance in 1999 (see Knowledge Management, section 7.5) the Bank has given due recognition to the issue of good governance because it is central to creating and sustaining an enabling environment for development. The absence of good governance has proved to be particularly damaging to the role of government. Programs for poverty alleviation, for example, have been undermined by pervasive corruption. Corruption weakens the ability of governments to carry out their functions efficiently and leads to inequitable distribution of government services. It squanders government revenues and distorts and deters investment flows, thus undermining growth. To this regard, the Bank in February 2004, approved the Guidelines for Preventing & Combating Corruption and Fraud in Bank Group Operations (see Knowledge Management Section 7.6).

1.1.4 The Boards noting the importance of an Anti-Corruption and Fraud Investigation Function, and the positive effects of institutionalizing the investigation of corruption and fraud decided, with effect from 1 November 2005, to renamed the existing Internal Audit Department (AUDT) as the Office of the Auditor General (OAG), and reorganized the Department to comprise a Directorate, and two Divisions, namely the Anti-corruption and Fraud Investigation Division (ACFD), and the Internal Audit Division (IAD) and approved their respective Terms of Reference as well as the mandate of the Oversight Committee on Corruption and Fraud (OCCF).

1.1.5 ACFD shall undertake investigations in response to specific allegations of fraud or misconduct against individuals who are staff members or third parties who engage in business with the Bank. The role of the investigator therefore shall be to determine the truth or falsehood of the allegation and to recommend appropriate sanctions against the offender. The OAG, in conjunction with OCCF will discuss and put in necessary controls around the following processes: receiving allegations; screening allegations of fraud and corruption; conducting investigations; etc.

1.1.6 The OCCF will ensure a fair system so that no individual wrongly accused shall be punished for an offence s/he did not commit and that no offender shall be allowed to go unpunished. The Committee’s responsibilities include amongst: Overseeing compliance with all
due process requirements of both the Bank and the RMCs in which activities are being investigated; Approving debarment and imposition of sanctions against individuals, firms and companies found to have engaged in corrupt practices; and recommending cancellation of loans where necessary; Reviewing and approving cases that should be forwarded to the national authorities for further action, including prosecution; and accordingly making recommendations to the President.

**Money Laundering and Terrorist Financing**

1.1.7 The Bank is concerned with growing global problems of money laundering and terrorist financing. The Bank is fully aware of the impact money laundering and terrorist financing can have on the financial systems of RMCs and their hampering of efforts to reduce poverty. In this context, the Bank is developing a Strategy and Plan of Action to assist RMCs combat money laundering and terrorist financing. The Bank plans to incorporate money laundering and terrorist financing issues in its policy dialogue with RMCs and to strengthen the Bank’s internal controls to safeguard Bank funds and prevent their use in money laundering or terrorist activities. The Bank recognizes that its efforts to reduce poverty contribute to addressing some of the root causes of these activities and that its efforts to assist RMCs to improve their financial management systems help to address these concerns. The Bank also recognizes that greater efforts need to be undertaken to ensure that money laundering and terrorist activities do not interfere with the Bank’s main goal of poverty reduction.

**Country Governance Profile**

1.1.8 The Bank’s instrument for review of the governance framework in a nation is the Country Governance Profile (see Knowledge Management, section 7.4). The Country Governance Profile (CGP) identifies the strengths and weaknesses of governance arrangements in a country and helps in assessing the risks that these may pose to the use of Bank funds. The Financial Analyst should read the CGP report carefully noting the financial management environment that the proposed program or project will operate within.

**African Peer Review Mechanism**

1.1.9 The African Peer Review Mechanism (APRM) is an instrument voluntarily acceded to by Member States of the African Union as an African self-monitoring mechanism. Its mandate is to ensure that the policies and practices of participating states conform to the agreed political, economic and corporate governance values, codes and standards contained in the Declaration on Democracy, Political, Economic and Corporate Governance\(^1\). Like the CGP, the APRM enables the identification of Member States governance related deficiencies and assesses the needs for capacity building.

1.1.10 The Bank can lead the policy dialogue with RMCs over the implementation of the corrective undertakings identified in the APRM Program of Action. It can draw lessons from experience, and distil a collection of good governance related best practices as well as support monitoring and reporting progress in area of governance in RMCs to interested stakeholders. To this regard, the Bank and the New Partnership for Africa’s Development (NEPAD) should dialogue on ways to harmonize the CGP, and the APRM processes.

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1.1.11 Based on the Bank’s Operations Manual and other related guidance documents, this Chapter of these Guidelines is aimed at providing the financial analyst with a comprehensive view of financial management. In addition to this introduction, this Chapter has the following two sections:

- **2.2 – Country Financial Management Systems** – Approaches for examining the various institutions and agencies of borrowers, particularly as they impact on the financial management of programs and projects are reviewed in this section.
- **2.3 – Executing Agencies** - This section is applicable to the executing agencies of all projects. It describes the analysis of the EA’s systems and procedures that will be utilized to implement and manage the project. Importantly it introduces an innovative tool to assist the Financial Analysts to make an assessment of the adequacy of the financial management systems. It contains advice on how to design and cost institution development initiatives in the area of financial management as well as the implementation strategies and major risks that should be taken into account when planning institutional strengthening measures.

### 1.2 COUNTRY FINANCIAL MANAGEMENT SYSTEMS

#### Financial Management Systems

1.2.1 Financial management systems\(^2\) include budget planning and implementation systems, procurement systems, financial statement preparation systems and audit systems. These systems are utilized across government and apply equally to ministries and other government agencies that may be implementing a budget support or sector loan, an investment project loan, a line of credit or a grant.

#### Harmonization

1.2.2 Donors recognize that country ownership is enhanced and harmonization efforts facilitated through the use of country financial management systems. In response to the efforts of both donors and developing countries to increase the effectiveness of development assistance an increased focus has been placed on holistic approaches to addressing development issues. Two High Level Forums on development issues have been held to discuss the role of the development community in achieving the Millennium Goals established in the United Nations Monterey Declaration. These forums focused on Aid Effectiveness and Harmonization\(^3\) and issued declarations calling for greater reliance on developing country systems, minimizing independent project financial management systems and on recognizing the need for and providing institutional assistance to national governments to improve their country systems.

1.2.3 While the Rome Declaration expressed support for greater use of RMC country systems the Paris Declaration seeks to set specific measurable goals for achieving greater ownership and alignment of aid with country priorities and use of country systems. The Paris Declaration has set

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\(^2\) Financial management in government requires accountability of financial and program managers for financial results of actions taken, control over the government's financial resources and protection of governments’ assets. To enable these requirements to be met, financial management systems must be in place to process and record financial events effectively and efficiently, and to provide complete, timely, reliable and consistent information for decision makers and the public.

\(^3\) Paris Declaration on Aid Effectiveness, Paris, France March 2, 2005 and Rome Declaration on Harmonization, Rome, Italy February 25, 2003, respectively (see Knowledge Management, section 7.3).
five goals on a tentative basis with seven additional goals and the five tentative goals to be confirmed by September 2005 (Knowledge Management, section 7.3).

1.2.4 The Bank encourages collaboration with development partners in the preparation of the CGP. Collaboration may take the form of joint preparation of a CGP with one or more development partners or it may take the form of reflecting in the scope of coverage of the CGP the work undertaken by a development partner or by a partner country. The World Bank and/or the International Monetary Fund often collaborate with the Bank to undertake the following studies which should be reviewed and considered during the preparation of a CGP and/or during preparation of a project or a programme:

- Country Procurement Assessment Report (CPAR), which reviews public procurement institutions and practices in borrower countries,
- The Public Expenditure and Financial Accountability Review (PEFAR) that reviews the Public Financial Management (PFM) arrangements in client countries. PEFAR has two main components – the Financial Accountability Assessment and the Public Expenditure Review (see Knowledge Management, section 7.10).
- The Public Expenditure and Financial Accountability (PEFA) PFM Performance Measurement Framework, included in section 7.11 of the Knowledge Management, provides a common pool of information for measurement and monitoring of PFM performance progress.
- HIPC Expenditure Tracking Assessment, which assesses the ability of highly indebted poor country’s public financial management systems to track poverty reducing expenditures.

1.2.5 To remain effective and relevant to RMCs, the CGP will need to evolve into a more flexible and adaptive instrument, adequately differentiated among RMCs, and harmonized with APRM. On the one hand, in non-APRM RMCs, the CGP will remain a key governance assessment diagnostic tool. And on the other hand, in RMCs participating in the APRM, the CGP preparation will need to be sequenced to precede APRM assessments. This way the CGP findings will inform those undertaking country self-assessments within the APRM framework. In RMCs where APRM is already completed, the Bank’s CGP can be adapted to address coverage gaps and emerging areas not sufficiently covered in the APRM as well as moving forward the APRM findings and recommendations to broaden and deepen governance analysis in such areas.

**Budget Support Loans/Policy Based Loans**

1.2.6 Budget support loans provide funding intended to support agreed policy objectives, including reforms that result form policy changes. As a result most budget support loans do not have a specific investment program with a detailed cost schedule. However, in many cases the achievement of development goals envisaged under budget support loans depend entirely on the government making investments in a particular targeted sector. As a result the program is dependent on the government’s financial management system for the investment of funds to achieve the program goals.

1.2.7 The Agreement Establishing the Bank requires it to ensure that loan proceeds are used only for the intended purposes for which the loan was granted, with due attention to considerations of economy and efficiency. Normally, the Bank’s loan proceeds would be paid into a central bank account that is part of a country’s foreign reserves and an equivalent amount in local currency is credited to the government to finance its budgetary expenditure. For the
foreign exchange component the Bank relies on IMF’s findings of safeguard assessments of central banks.

1.2.8 For the Bank’s resources that are channelled through the government budget and, therefore, the country financial management system, the Bank conducts ex-ante assessments of the fiduciary risk inherent in the borrower government's accounting and procurement system. This is done through diagnostic work as well as reviewing country and other donor fiduciary assessments reports, including audits.

1.2.9 The fiduciary assessment informs the Bank’s decision as to whether the level of risk is acceptable. Where weaknesses exist, the Bank will take appropriate measures to mitigate and monitor the risks. The diagnostic tools that the Bank uses to assess fiduciary risks in the government financial management system are identified elsewhere in these guidelines.

1.2.10 By reference to the diagnostic assessments conducted by the Bank or by other donors, the financial analyst needs to determine the effectiveness of the government’s financial management system and describe in the appraisal report the system in general and in particular how it applies to any ministry or other unit of government responsible for implementing/achieving the program goals. The financial analyst should, also, assess the adequacy of available financial statements or budget utilization reports that would provide a summary of the operations of the ministry or agency and that would reflect the anticipated budget expenditures of the program.

**Sector Wide Approach (SWAps)**

1.2.11 The Bank’s guidelines covering SWAps (Knowledge Management Section 7.8), notes that a SWAp is neither a lending instrument nor an end product. It constitutes a process through which national policies and strategies are translated into sector investment and expenditure programs based on a country’s long-term development plan. The guidelines note that the intention of a SWAp is to pool funds and reporting for funds and to use common procurement procedures. However, noting that the Agreement Establishing the African Development Bank and the Agreement Establishing the African Development Fund require that “the proceeds of any loan granted, investment or other financing made in respect of the ordinary operations of the Bank shall be used only for procurement in member countries of goods and services produced in member countries,…..” and differences between donor financial management requirements, a pooling of funds involving the Bank’s resources may be difficult to achieve. The guidelines note that it is very likely that specific components of the Public Investment Programme supporting the sector may be financed by Bank project loans, that Bank provided grants may be utilized to support technical assistance for needed capacity building and that the Bank may channel resources in support of a SWAp using a budget support loan.

1.2.12 At the outset, sector staff should be aware that for fiduciary issues, it is not a “SWAp” that matters but the nature of financing and implementation arrangements that are proposed. There are three financing modalities options to support programs under SWAps. One option is a parallel financing arrangement whereby the Bank becomes fully engaged in intensive coordination around a common program/strategy through strong harmonization and coordination frameworks such as joint reviews, monitoring and evaluations, policy dialogue and use of common reporting formats. Pooled financing is a second option, whereby, all pooling partners would pool their funds, support the same scope of activities and use the same financing

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4 Agreement Establishing the African Development Bank, Article 17 (d) and the Agreement Establishing the African Development Fund, January 1981, Article 15, paragraph 4.
mechanisms and planning cycles. Lastly, SWAps may take the form of a general budget support that is directed to a specific sector.

1.2.13 The decision on whether to or not to enter into a SWAp will depend on three factors. First, in social sectors, where significant expenditures are largely recurrent, small and local, there is less need for fiduciary safeguards. Second, where difficult and contentious policy issues exist, it would be more difficult to agree on a common program. Lastly, in general, pooled financing is more challenging if large procurement, major environmental/social safeguard issues, and a large number of donors are present.

1.2.14 As in the case of budget support loans, a clear understanding of the country’s financial management system, including its budget approval, appropriation and expenditure reporting system, is necessary before the Bank embarks in a SWAp. Therefore, the Bank can embark on a SWAp only after it conducts a comprehensive and detailed review of the particular sector-wide as well as microeconomic issues.

1.2.15 The financial management system in a SWAp should produce timely, understandable, relevant, and reliable financial information that would allow the Bank, other donors, and the government to plan and implement the program, monitor compliance with agreed procedures, and appraise progress toward its objectives. To ensure that these financial management requirements are met a financial analyst should participate in a fiduciary assessment for the SWAp that should be conducted by the Bank in collaboration with other participating donor agencies. The Bank has not developed its own methodology of assessing fiduciary risks in a SWAp. This is an area that the Bank would need to work on as SWAps gain prominence in the Bank’s operations. In the meantime, staff would need to utilize methodologies developed by other donors to perform the financial management assessment of a SWAp.

Project Loans

1.2.16 Project loans provide funding for specific investments designed to achieve clearly defined goals including specified financial and/or economic goals. Where the EA is a unit of government it would be expected to follow the financial management policies and practices of the government. The purpose of the financial management assessment of the executing agency is to ascertain whether the EA’s systems are consistent with the government’s systems and to evaluate the EA’s accounting systems and internal control systems to verify that the EAs standards are adequate and to ensure that an effective framework for accounting and financial reporting is developed during appraisal (Knowledge Management section 7.9, OM 600). Issues or defects in the government financial management system may be identified as a result of an analysis undertaken as part of the processing for an individual investment project. The issues or defects identified may be addressed through the investment project or separately.

1.2.17 Financial management systems of EAs serve two equally important goals, both of which are expressed in the requirement to ensure that funds are used for the purpose intended. One goal is to use the financial management system as a tool to assist the project manager in ensuring the development objects of the project are achieved, which is the purpose intended. To achieve this, the project manager needs to know the total funds available to complete the task, the source(s) of the funds, any prerequisites to accessing the funds, restrictions on utilizing the funds and the currency or currencies the funds are available in, etc. The financial system needs to track the utilization of each pool of funds, the balance of funds available to complete the project and the expenditures incurred to date for each cost category of the project.
1.2.18 Another goal is to give to each of the providers of funds (including the government) an accounting of the use of all funds provided, informing them that their funds were utilized for the purpose intended. The financial management system needs to incorporate internal controls that ensure any prerequisites to utilizing the funds are first met, any restrictions on the use of the funds are observed and that there is a timely accounting to the providers of the funds.

1.2.19 Financial reports that meet the needs of the project manager should be sufficient to meet the needs of the funding agencies. A single financial report covering all sources of funds, accounted for in the national currency, and reporting all direct and indirect disbursements related to the project and with additional information in the Notes to the Financial Statements would be appropriate. Indirect disbursements are payments made by a funding agency to a supplier on behalf of the borrower/EA. The Notes to the Financial Statements should indicate at least the accounting standards applicable to preparation of the financial reports, any deviations in the application of those standards, and sufficient information about the funding arrangements to understand the main financial terms and conditions.\(^5\)

1.2.20 While financial aspects of these matters should attract a financial analyst’s principal attention, they must be aware of, and capable of responding to other factors. These may be related economic and technical objectives, techniques of design and implementation, and the operation of the project, together with the impact of any related, ongoing facilities and activities with which the project will be linked. These may include parallel investments in the same or other sectors that should appropriately be linked to achieve common economic objectives. For example, the construction of water supply and sewerage facilities by different EAs, or by the same agency drawing on differing sources of funding, should have common economic, financial and environmental objectives. These should be related to achieving appropriate standards of public health, including recognition of the financial impact which good health has upon the earning capacity of the population concerned.

**Local Government Financial Management**

1.2.21 Effective and efficient local government budgeting and financial management is the cornerstone of any effective decentralization strategy. The task of improving local government financial management systems is enormous. The legal framework varies across countries. Local governments vary in size, financial and economic resources. As a result, there is no singular financial management system that can be applied across the board to all local governments and countries. What is similar across countries and local governments is the conceptual framework of modern budgeting and financial management. The application of these budgeting and financial management practices may however vary across countries.

1.2.22 The Knowledge Management Chapter of these Guidelines (see section 7.12) reviews the core elements that underpin effective frameworks relating to local government budgeting and financial management practices. Financial Analysts charged with the task of assessing financial management systems at sub-national levels of governments are advised to be familiar with the materials presented therein.

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\(^5\) Harmonizing Donor practices for Effective Aid Delivery, Chapter 5, OECD-DAC Guidelines and Reference Series 2003 (Knowledge Management, section 7.7)
Partnership Arrangements

1.2.23 The Bank will take the opportunity to engage in policy dialogue related to use of country financial management systems with RMCs as well as strengthen collaboration to build country systems between the Bank and other donors. An effective strategy to strengthen country systems must build on gains in this area and be grounded in a vibrant partnership setting between the donors and the RMCs and amongst the donors themselves. It is expected that much of the Bank’s role on this initiative will involve sensitizing RMCs to improve fiduciary arrangements on the one hand, and coordinating and harmonizing with other donors on the other.

Other Issues

1.2.24 Every Appraisal Report prepared (including those for budget support loans and SWAps) should include a focused description of the main features of the country’s financial management system. The strengths and the weaknesses of the system should be described. Where weaknesses are identified the appraisal report should describe how those weaknesses would be addressed in the implementation and supervision of the proposed program or project. Comparisons of the country financial management system with international best practice provide the reader with a basis to view the financial reports and financial data included in the appraisal report in context. The Bank’s past experience in relying on the RMC’s financial management systems should also be described. A key challenge is, therefore, for the financial analyst to review the various financial governance-related assessments that have been conducted by the Bank and/or by other developmental partners/partner countries, and summarise the key conclusions that will be documented in the Bank’s Appraisal Report.

1.2.25 Circumstances may exist at the time of the preparation of a program or project where the prescribed financial policies, strategies and systems of the government in part, or as a whole, contain defects not acceptable to the Bank and which may affect the design and execution of the program or project. In such conditions, the design of the program or project should include means of eliminating or where necessary counteracting these defects thereby enabling the financial analyst to confirm at appraisal that the EA’s financial management systems will be sustainable. This means that the financial policies, strategies and systems of the government must be adequate to underpin the EA’s financial management systems and support the program or project and the EA from start-up, through implementation, and where appropriate, during the operation of a project.

1.2.26 International best practice requires donors to rely on partner country financial reporting systems when the financial reports meet the information needs of government and donors. The Paris Declaration seeks to harmonize donor practices on the basis of the partner country financial management systems and accounting standards rather than introducing accounting standards developed in a donor country or continuing the practice of utilizing donor specific systems on each donor funded project. The appraisal report should clearly state the decision made regarding whether or not the partner country financial management system will be relied upon, relied upon with assistance or support from a PIU, or whether an independent PIU is necessary. Where the partner country financial management system requires assistance or support from the PIU or a separate PIU is deemed necessary capacity building should be a priority of external assistance. The Bank will increasingly need to be able to demonstrate why it relied on or why it did not rely on the financial management system of the partner country.

1.2.27 The financial analyst is required during preparation or at the latest by appraisal to obtain sufficient information to advise the Bank whether a program or project has been developed to
operate within the existing framework of governmental financial policies, strategies and systems. Where the existing framework of governmental financial policies, strategies and systems contains defects that are not acceptable to the Bank the financial analyst is required to advise the Bank whether steps will be taken under the program or project to correct the defects or whether acceptable countermeasures have been designed into the implementation of the program or project. The financial analyst should also determine whether the program or project is fully aligned with the Bank’s policies. The Bank typically uses various covenants in loan agreements to reinforce this determination.

1.2.28 When designing covenants for inclusion in the loan’s legal documents consideration should be given to the steps that needs to be undertaken by the government in applying policies, strategies, and systems acceptable to the Bank. These steps should support the program or project from the start of its implementation throughout its life. Also, policy dialogue should be conducted to remove concerns or unacceptable policies and practices. Consideration should be given to addressing the institutional strengthening needed as part of the current project or by providing standalone technical assistance.

1.2.29 Following program or project inception, the financial analyst is required to continually assure the Bank’s management that the above framework will facilitate the accomplishment of the program’s or project’s goals. The financial analyst should also draw management’s attention to any change, which has occurred, or is under consideration or planned, in financial policies or strategies or systems, (including failure to comply with financial covenants) which could reduce project effectiveness.

1.3 EXECUTING AGENCIES

Introduction

1.3.1 The Bank requires that to the maximum extent possible a program or project be designed, developed, and operated (among other factors) within the framework of the financial policies, strategies and systems prescribed by those institutions of the government which are responsible for national and sector economic and financial planning. Where use of country systems is not feasible, additional safeguards and measures are to be established in ways that strengthen rather than undermine country systems and procedures.

1.3.2 The Paris Declaration on Aid Effectiveness adopted at the High-Level Forum in March 2005 reaffirmed the donor community’s commitment to align their programs to national development strategies, institutions, and procedures. It identified a reduction in the number of parallel project implementation units (PIUs) as one of the key actions the aid community could take to promote greater capacity development within borrower countries, and thus increase aid effectiveness.

1.3.3 Greater integration of project management in a country’s existing institutions and systems is important to the Bank’s objective of developing institutional capacity in its RMCs. Equally, it promotes, the Bank’s objective of making concrete steps towards greater use of country financial management systems. Importantly, developing country institutional capacity is an integral part of the Bank’s mission to reduce poverty and promote sustainable development, in Africa.
1.3.4 On the one hand, formation of PIUs to execute project implementation reflect the need to mitigate risk that Bank’s loan proceeds might be used for purposes rather than that intended when the loan was approved. This is especially the case where project implementation capacity is weak. But on the other hand, created PIUs reflect sector staff incentives to ensure that projects are implemented speedily so as to reflect high implementation performance ratings.

1.3.5 The outcome is often PIUs that vary in size, function, physical location, legal status, and degree of integration into existing country structures. First, “Stand-alone” or “enclave” PIUs are typically formed outside the structure of an EA and are responsible for a “turnkey” solution to the final outcome. At project closure, the completed project is then handed over to the parent ministry for operation. These PIUs duplicate functions and capabilities of the ministry that oversees the sector and are generally considered to be most damaging to long-term country institutional development efforts. Second, “Semi-integrated” PIUs partially augment the existing structures within the EA with some capacity, for example, long-term technical assistance and/or specialists to address some functions or capabilities. Third, “Super” PIUs take a sectoral approach to implementation of projects and are financed by different donors. Another variant of “Super” PIUs is found where a single donor forms an implementation unit covering multiple projects in a sector or for related projects in a region. Fourth, “Semi-autonomous Agencies” are either newly created or already existing institutions outside mainstream government. They implement programs (e.g., social funds) and thus eliminate the need for further project implementation units. Lastly, in the case of “Fully Integrated” PIUs the EA/government ministry takes full responsibility for project implementation and uses its own structure and staff. Although donors may support “Fully Integrated” PIUs with limited technical assistance for specific areas, they significantly promote institutional capacity development.

1.3.6 The recent shift toward greater use of country’s procedures and institutions, with proper fiduciary safeguards, means that Bank staff should have detailed knowledge about a country’s rules and practices, especially in sectors where the Bank expects to be engaged in over a long period. Then, during project preparation, Bank staff should agree with the borrower the appropriate measures to align procedures, and design safeguard measures that are as closely integrated with government systems as feasible. Country Departments will need to develop country-level strategies on project implementation arrangements including PIU staff remuneration and other incentives to minimize distortions, while pursuing broader civil service pay reforms.

1.3.7 These Guidelines while encouraging Operations Complex staff to continue giving priority to efficiency of project implementation performance they should also ensure that Bank’s mandate to strengthen country institutional capacity development is not overlooked. To this regard, use of existing country institutions for project implementation should be the “rule” rather than the exception and PIUs, especially parallel “stand-alone” PIUs, should be phased out.

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6 This discussion is summarized from the following World Bank document: Guidance Note for Project Management: Strengthening Institutional Capacity during Project Implementation, October 2005 (Knowledge Management, section 7.3.7).
1.3.8 It is important for Financial Analysts\textsuperscript{7} to view financial management assessment in the context of the country financial management system and to relate the program or project being processed such systems. Such a review is undertaken to understand the setting within which the program or project will operate. The review starts at the national level. Financial Management at the national level sets the tone for financial management in lower levels or units of government. Financial management is an integral component of the governance framework of a nation. Usually laws are passed by the national legislative body or bodies that establish the means by which revenue is raised, debt is incurred and funds are budgeted and appropriated. Laws or regulations provide authority to various Ministries/Departments and units of government to spend money and the means by which resources spent are accounted for and reported to the legislative body and to the public. Detailed regulations will establish the rules for procurement, internal control, accounting standards followed by the government and the content and timeliness of financial reporting.

1.3.9 The project should respond to clearly defined objectives, including among others, sustainable economic goals; execution based on the least cost technical solution; time-bound delivery of benefits; and in the case of project loans - financial viability. The Bank has a broad interpretation of financial viability in relation to project loans. It implies at an optimum, the ability of a project to replicate itself, to finance day-to-day operations and maintenance, and to service its debt. As a minimum, financial viability should represent the provision of adequate funds to finance day-to-day operations and maintenance. The funding may come from either service fees or product sales associated with the operation of the project itself and/or from sufficient government budgetary support to assure the Bank that a partial revenue earning or a non-revenue earning investment will generate the intended levels of economic benefits through its working life.

1.3.10 Investment projects selected for Bank support may be the responsibility of borrowers, EAs and/or Implementing Agencies (IAs)\textsuperscript{8} that have already implemented or are in the process of implementing an investment project for the Bank or for another International Financial Institution. In support of the harmonization agenda the Bank is willing to share, with other Developmental Partners, its governance assessments as well as utilize the assessments of other MDBs. Accordingly where the borrower, EA or IA has been assessed recently the Bank will only undertake the minimum work necessary to update such as assessment to meet its current requirements.

1.3.11 The rest of this Chapter equips financial analysts with tools to evaluate EAs and project specific institutional capacity in the area of financial management.

**Scope Of Financial Analyst's Work**

\textsuperscript{7} A financial analyst should have adequate financial management skills to enable him/her to conduct an effective financial management assessment. Where such capacity does not exist within the concerned Operations Department, a short-term consultant with adequate financial management skills should be recruited to conduct the assessment. To this regard, a sample Terms of Reference for recruitment of such a consultant is included in section 7.13.11 of the Knowledge Management chapter of these Guidelines.

\textsuperscript{8} The project financial management system depends on the nature of the project and of its implementing entity, which could be a self-standing Project Implementing Unit (PIU), Project Co-ordination Unit (PCU), Project Management Unit (PMU), Project Liaison Unit (PLU), a government ministry, department, or agency, or a commercial entity. These guidelines use ‘IAs’ to refer to all of the above.
1.3.12 Operations Manual 600 set out the Bank’s policy with respect to the need for the examination of the EA’s financial management systems during project preparation and appraisal. This is to form an assessment of the financial policies and the capacity of the financial management systems in place or proposed by the borrower or EA to support project implementation and operation.

1.3.13 The identification, preparation and appraisal activities to be undertaken by a financial analyst prior to loan negotiations should be adequate to comply with the requirements of OM 600 (Knowledge Management, section 7.9). Identification and preparation of an investment project requires a financial analyst to obtain a detailed knowledge of the institutions and systems that are, or will be used during implementation and where appropriate, future operations. This task includes, among other things, acquiring the knowledge and ability to determine at or before appraisal and preparation of the Appraisal Report, whether or not the financial management system(s) proposed by the borrower and the EA will be sustainable from project start-up, through implementation, and where appropriate, for the continued operation of the project.

1.3.14 The financial analyst should advise the Bank in all cases where, in his/her judgment, the level of financial management arrangements proposed by the EA would be adequate to sustain the proposed project or the financial viability of the EA – especially if no defined modifications are to be set in place. This advice should be stated in the Back to Office Report of the Appraisal Mission and take the form of a clear statement included in the Appraisal Report.

1.3.15 Where appropriate, the financial analyst should make recommendations to the borrower and the Bank regarding minimum changes to be made in financial management, considered necessary to assure efficient and effective delivery of the proposed project from start-up. The financial analyst should advise the EA and the Bank regarding those elements of a financial management system that either should be put in place before start-up or within a defined time after start-up to enable the financial management system to operate at full efficiency. The elements identified may constitute components that are to be financed as part of the project, and completed in accordance with a timetable acceptable to the Bank or may be incorporated into a separate technical assistance project.

1.3.16 The extent of a financial appraisal will depend upon the extent and type of experience the Bank has had with the concerned EA, the EA’s experience in implementing programs or projects, and the extent and nature of previous institutional strengthening. Broadly, the Bank conducts financial appraisals of EAs and IAs to determine whether such institutions are technically, managerially and financially capable of efficiently and effectively implementing proposed projects. The specific objectives are to:

- Decide whether institutional financial management capacity is sufficient to support loan approval;
- Identify any institutional financial management needs – both project related and long term – that should be addressed either as a project component or by technical assistance; and
- Confirm that the financial management system is sustainable.

1.3.17 The appraisal scope, pertaining to financial management activities, should include:

- Analysing the EAs’ structure and management framework with regard to financial management;
- Assessing the agency’s compliance with national accounting, reporting and auditing standards and relating those standards to International Standards;
• Assessing the agency’s resources, including the number, quality and technical capabilities of its staff, the extent of financial and budgetary support it receives, the nature of technology, equipment, software in use; and
• A diagnosis of performance shortfalls to identify specific institutional deficiencies and related institutional strengthening interventions. The institutional deficiencies should be classified into those pertaining to the management framework and those due to resource constraints.

Categorizing EAs

1.3.18 EAs are critical to the success of the design and implementation and, in many cases, operation a project. Within the public sector operations of the Bank, EAs are broadly classified into the following three types:
• Agencies, which include government line agencies and state/provincial arms of such agencies, and local governments; and
• Statutory bodies, public sector enterprises, or government-owned bodies such as agricultural and industrial credit banks and the like.

1.3.19 EAs are further classified as revenue-earning and non-revenue-earning. The term revenue-earning encompasses EAs and projects which are commercially oriented. Revenue-earning would also cover public sector institutions which generate substantial revenues either by consumer charges or forms of sector-specific local taxation (property tax levies for water supplies, drainage, etc.), or both. Examples are public sector commercial and industrial enterprises, public utilities, telecommunication companies, industrial and agricultural credit banks and municipal government utility operations. Non-revenue-earning projects are usually implemented and operated by public sector EAs whose financial support derives predominantly from central, provincial, state and/or local government budget allocations, and for whom there may be no service fee or only partial cost recovery, often accomplished indirectly. Non-revenue-earning EAs include government ministries and departments, and project EAs under their control in sectors such as education and health.

1.3.20 An EA may have a tiered management in the form of a Project Management Unit (PMU), with the PMU having one or more Project Implementing Units (PIUs). In such cases, the EA is responsible to the borrower and the Bank for the successful implementation of the project, including delivery of all financial reports and auditors’ reports and opinions in accordance with agreed timetables.

Determining the Status and Role of EAs

1.3.21 An EA is likely to be subject to laws, regulations and rules that are administered by superior authorities, typically ministries or departments. Departments that have control over EAs, may themselves be agencies of state or provincial governments that also are the subjects of superior central administrations. Therefore, the extent of an EA’s autonomy and/or control by superior authorities at all levels of a national government’s hierarchy should be established. This is in order to determine its authority and ability to formulate and implement financial policy, and to design and install financial management systems.

1.3.22 To resolve these concerns, answers should be sought to the following questions:
• Is the EA fully autonomous (for example, can it legally exist in its own right by the laws of the country without government control)?
• Can it contract, and sue and be sued in its own name?
• Can it determine its own financial policies?
• Is it government-controlled? If so, what is the extent of that controls and influence on financial policies and accounting and auditing requirements?
• Is there a specified national code or chart of accounts?
• Is it a government agency? If so, does the EA’s management have any powers to decide financial policy, determine its own accounting systems and financial management rules, or does government prescribe these? For example, there could be separate accounting rules for public sector enterprises.
• Is the project to be executed by only a part of an EA?
• Is it necessary or desirable to require a separation of accounts and/or funds for only that part of the EA, and would such a step be feasible?

1.3.23 It is possible that an EA may not have a definitive view of its related governance, particularly the actual superior levels of control. In such circumstances, it may be prudent to seek the advice of the government auditor. Government auditors are often well informed on national legislation and of the powers and duties of the agencies for which they have audit responsibility.

Assessment of Financial Management

1.3.24 Financial management assessment field work comprises the following four steps:
• Planning the assessment;
• Conducting the assessment;
• Recording the assessment; and
• Assuring the quality of the assessment.

1.3.25 To assess risks that the project may face, the Financial Analyst should evaluate factors at three different levels--country specific, entity specific, and project specific. For country specific risks, the Financial Analyst is expected to draw upon the existing analytic work (such as CGP, PEFAR, PEFA-PFM, CPAR, etc). However, entity and project specific risks are assessed every time the financial management systems are assessed for an individual project. Risks assessment in relation to the project implementing entity is primarily conducted in three areas: (a) institutional and organizational aspects, (b) funds flow, and (c) audit arrangements. In some projects the distinction between the entity and project may be nonexistent as the project implementing unit (PIU) is created exclusively to implement the Bank Group-financed project. In such a case one assessment for both entity and project risks would suffice.

Planning the Assessment

1.3.26 The financial management assessment should commence as early as possible in the project preparation process to allow for early detection and resolution of issues. The financial management assessment starts with a contribution to the following sections of the Project Briefs: technical assistance requirements; issues and proposed actions; and sector assumptions/risks. Participation by Financial Analysts, with financial management expertise, at this stage helps plan the scope of the assessment, and allows the impact of any known financial management issues to be taken into account in early project design decisions. The assessment will need to be updated as project preparation progresses to reflect the most recent status of the financial management system, including whether previously agreed actions have been taken.
1.3.27 Planning the assessment should be performed in close coordination with the project’s Task Manager who can assist the Financial Analyst to understand the project’s overall context, including specific demands that will be placed on the financial management system. This discussion would be the foundation for continued interaction, as required, during the assessment and project preparation/appraisal processes. When planning the assessment, the Financial Analyst should focus on the following issues that will impact its quality:

- Obtaining sufficient knowledge of the country, the implementing entity and the project before commencing the assessment work in the field;
- Planning and communicating the work the Financial Analyst will perform during the assessment; and
- Determining the minimum financial management requirements appropriate to the project.

1.3.28 During the planning phase, the Financial Analyst should estimate the resources required to complete the assessment. The resource requirements (for instance, budget, time, technical skills) and how they will be met should be discussed and agreed with the Task Manager and the Financial Analyst’s supervisor before starting the assessment. Resource requirements will be affected by the amount of analysis of the financial management systems of the implementing agency carried out as part of the technical assistance for project design.

1.3.29 In accordance with Bank policy stated above, the focus should be on using the government’s financial management system to the extent possible rather than creating a new system for the project. An understanding of the country’s financial accountability framework (essentially the rules, regulations and institutions which provide assurances that public resources are used economically and efficiently) will assist the Financial Analyst to highlight the financial management and fiduciary risks to which the proposed project may be exposed. The Bank’s CGP and the World Bank’s PEFAR are useful sources of this information. Other sources may include other Bank diagnostic economic and sector work, similar reviews conducted by other donors, and reports from borrower country institutions. This information should be used as reference documents so that analysis of the country issues is not replicated in full in the assessment. Project specific information gathered during the planning phase should be included in the supporting documents.

1.3.30 Financial management issues such as the following should be considered during the project planning phase:

- What the country financial analytic assessments, such as the CGP, PEFAR, PEFA-PFM, CPAR and experience with the existing country portfolio tell us about accountability issues, corruption, financial management capacity, etc;
- Do aspects of the proposed project design have significant financial management implications or risks? If so, how should such issues be identified and approached?

1.3.31 Where a financial management assessment has previously been conducted on a proposed EA in the context of a previous Bank Group project, it would not be necessary to conduct a full assessment for a new project. In deciding on the extent of work, if any, to be carried out on the new project, the Financial Analyst should take into account the date of the previous assessment and experience with implementation of the financial management aspects of the previous project. In countries where there is a high degree of homogeneity between implementing agencies, experience with previous projects, as well as knowledge gained from available country assessments, will often mean that less detailed work will need to be carried out in the assessment of a new project. Where the Bank Group is planning to co-finance with another donor and there
is alignment of project preparation/appraisal schedules, opportunities should be sought for sharing
the work in support of, and conclusions from, the financial management assessment work.

**Conducting the Assessment**

1.3.32 This sub-section covers the following areas:

- Assessment Methodology
- Designing the Institution Development Proposal
- Types of Institution Development Interventions
- Costing of the Institutional Strengthening
- Implementation Strategies
- Risks

**Assessment Methodology**

1.3.33 An agency’s capacity to achieve results mainly depends on: (i) its structural and
managerial ability to effectively and efficiently employ its resources; and (ii) the extent of
resources mobilized in the form of financial budgets, the number and quality of staff, and the
extent and type of materials and equipment. The Bank Group’s principal concerns are to ensure
that the project’s development goals are delivered in a timely manner and that project funds are
used economically and efficiently. In support of this, it seeks to ensure that the financial
management system can report on the source(s) and payments from the project funds. The
primary responsibility of the Financial Analyst is to assess the adequacy of the financial
management system to meet the Bank’s concerns. The responsibility for maintaining an adequate
financial management system rests with the borrower. In assisting the borrower to evaluate, and
if necessary strengthen, financial management capacity self-assessment techniques are likely to
be useful, particularly at an early stage of the assessment process. To build ownership of the
diagnosis and the resulting action plan, the Financial Management Questionnaire (Knowledge
Management, section 7.13) should be completed by the borrower before the assessment begins.
The borrower may supplement its capacity to carry out the self-assessment with consultants or the
external auditors. If the Financial Management Questionnaire (FMQ) is completed as a self-
assessment, then the Financial Analyst will review the checklist as part of the financial
management assessment. When a self-assessment approach is not used, the Financial Analyst
should complete the FMQ.

1.3.34 The FMQ provides an indicative list of issues and questions to be considered in the
assessment. It is clearly difficult for a single questionnaire to adequately cover the diversity of
the Bank Group’s operating environment and projects. The FMQ may therefore be customized to
to better address specific project circumstances by adapting the questions (adding, deleting, or
modifying, as appropriate) to better suit the objective of the assessment. The weighting to be
given to individual questions or control areas varies from project to project.

1.3.35 A central aspect of the FMQ is an evaluation of the risks associated with the project
financial management arrangements. Assessing the risks involved in the project and their
materiality helps in choosing the appropriate course of action to ensure robust project financial
management arrangements. Assessment of risk is an important part of the financial management
assessment work. Annex D of the FMQ sets out an approach to assessing risk by applying the
model of inherent risk and control risk to the assessment.\(^9\) For each topic in the FMQ, there is space to indicate the level of risk—high, substantial, moderate, or negligible/low. The summary risk analysis is used to bring together the component risks into an overall risk analysis.

1.3.36 The next step is for the Financial Analyst to make an assessment of the adequacy of the project financial management system following four basic steps:

1.3.37 **Step 1: Analyze the EA’s Structural and Management Framework:**
   - Examine the organization’s structure with regards financial management. This will include an analysis of how functions are distributed and distinguished, how roles, responsibilities, and authorities are delineated and apportioned both vertically and Financial Management of Executing Agencies horizontally, what are the key lines of command etc. Also included should be an analysis of links with collaborating agencies also operating in the sector concerned.
   - Examine the agency’s main administrative and management systems and procedures, in relation to financial management. These should include operational planning and programming systems, financial management and budgetary processes, and management information and monitoring systems.

1.3.38 **Step 2: Assess Institutional Resources (Inputs)**
   - Assess the number, qualifications, and experience of financial management staff at all key levels.
   - Assess for all relevant periods, the extent of financial support available in terms of investment budgets and operating budgets. These should be described by major items, as well as by allocations made to various operational units, both functional as well as geographical.
   - Assess the adequacy of agency accounting information systems.

1.3.39 **Step 3: Assess Institutional Results (Outputs)**
   - Develop agency consolidated financial statements (against budgets) for each functional area, for relevant operating periods, and for geographical agency units (if these exist).
   - Also develop consolidated financial statements for past operating periods (including growth trends, if possible) and compare these against similar agencies (comparator agencies may be similar agencies in other countries where the socio-political environment, the cultural context, and the geographical dimensions of operation are similar).
   - Identify financial performance shortfalls or variances by comparing current performance with targeted performance, past performance-growth trends and, if feasible, with the performance of comparator organizations.

1.3.40 **Step 4: Analyze Performance Shortfalls**
   - Develop a diagnostic analysis of linkages between identified financial performance shortfalls/variances and deficiencies in the agency’s resource availability and management framework. This should be done in collaboration with the agency’s top management. These analytical findings should be agreed with the agency’s management.

\(^9\) This approach is largely based on IFAC Standard 400 “Risk Assessment and Internal Control.”
• Together with the agency’s management, develop alternative institution-building interventions, with regards financial management arrangements. These should be prioritized and based on an alternatives-analysis, using criteria such as cost, envisioned scope of impact, degree of risk, ease of implementation, etc.

Design the Institution Development Proposal

1.3.41 Types of Institution Development Interventions, with regards financial management:
• When planning and designing institution development proposals (based upon project preparation), staff should keep in mind that institutional strengthening can be targeted at resource enhancement or management upgrading or both, depending on the needs identified. As a general rule, resource enhancement should be resorted to first, if this option is available, since this can be achieved more easily and quickly.
• The caveat, however, is that resource enhancement is normally only a short-term solution to institutional deficiencies and should preferably be supported by more basic institutional changes or upgrading. Changes in or upgrading of policies, strategies, structures, administrative and management systems, etc. are far more difficult to achieve, require strong institutional support and commitment, and consequently a more extended time frame. On the other hand, they have a more lasting and permanent impact on institutional efficiency and effectiveness.

1.3.42 A general checklist of the types of institutional strengthening that may be focused upon in an institution-building proposal is given below.
• Resource Enhancement
  — Staffing: enhance staff availability, reallocate staff resources, upgrade staff skills (training);
  — Budgets: enhance operating budgets, reallocate funds by item; and
  — Technology: enhance availability of equipment and materials, improve quality of equipment, introduce new types of software.
• Management Upgrading
  — Policies and Strategies: review, revise, change priorities, adjust funding allocations, adjust strategic emphasis, build research and analytic capability, enhance “market” or “sector” information system, etc.;
  — Organization Structure: change and reassign roles and responsibilities change lines of authority, revise position descriptions and position hierarchies, establish task groups, create coordination mechanisms, strengthen linkages with collaborating agencies, etc.;
  — Administrative and Management Systems and Procedures: revise, upgrade, simplify, reorient basic systems and procedures such as: planning and programming, financial management, operations monitoring, information feedback, personnel management and compensation, incentive systems, etc.; and
  — Leadership Style: revise methods of communication, methods of involving staff at all levels, build openness and willingness to innovate, etc.

Costing Institutional Strengthening

1.3.43 If part of a project, the institution strengthening measures should preferably be consolidated into a discrete component to facilitate project administration. The costs relating to such a component would usually include (i) consultant services; (ii) civil works (e.g., training
centre), equipment; (iii) training expenses; and (iv) administration overheads (e.g., for the training centre). Some of these costs could be recurrent costs that will continue to be incurred even after project/TA completion.

1.3.44 In such a case careful consideration should be given to whether the Bank should fund such costs during project/TA implementation: if so, to what extent; and does the government have the capacity to meet such recurrent costs after project/TA completion. Given that TA resources are limited, the availability of co-financing or funding from other donors should be examined.

Implementation Strategies

1.3.45 Implementation strategies will necessarily depend on the type of institution development interventions planned. However, staff should bear in mind the following when planning and scheduling the implementation of institution development interventions with the agency concerned.

- Institutional strengthening measures, especially those which relate to the upgrading of the management framework, have to be implemented in a gradual and phased manner. Like a person, an institution takes time to learn, adopt, and adjust to new and revised forms of behaviour.
- Experience has indicated that it is very useful to make use of implementation workshops. These are carefully structured discussion sessions of small groups of concerned institutional staff held periodically. Their primary objectives would be as follows: (i) creating awareness and recognition of the need to change, revise, and upgrade; and developing the commitment to do something about it; (ii) action planning to ensure the active involvement of all concerned and to facilitate briefing of what is required; and (iii) reviewing implementation to assess progress and impact, and to accordingly adjust the direction, focus, schedule, etc. of the institutional strengthening program.

Risks

1.3.46 Some of the major risks that should be taken into account when planning institutional strengthening measures (in relation to financial management arrangements) are as follows:

- In the case of resource enhancement, do not create dependency.
- In the case of management upgrading, do not create disorientation by introducing too many changes too quickly.
- Do not overlap or conflict with already ongoing institutional strengthening initiatives.

1.3.47 Institutional strengthening programs should also always be proposed and undertaken by the Bank with caution, care, and a great deal of responsibility. This is because the longer-term risk potential with institution-building programs is usually greater than those related to the transfer of capital and investments. Furthermore, these types of program can create dependency or result in the transfer of inappropriate technology.

1.3.48 If not done in a circumspect and phased manner, attempts to revise or upgrade the management framework can create serious institutional disorientation, especially if prior commitment at all levels has not been ensured for the changes being implemented.

1.3.49 External financing agencies tend to view “their” project as the most critical. Consequently, institution-building activities can be implemented in a parallel rather than a
complementary manner. This usually confuses, rather than assists, the institution concerned. In the longer term, the results of a misguided institution-building program can consequently be quite the opposite than what was originally envisaged. It is, therefore, always necessary and essential to proceed cautiously and with an action learning format that is structured to include phasing, review, and consequent program readjustments in an ongoing cyclical process.

**Recording the Results of the Assessment**

1.3.50 The results of the assessment are documented in the Financial Management Assessment Report, with a separate file for relevant supporting documentation. The overall assessment is stated in the executive summary of the assessment report. If the system is considered inadequate, the report should identify the actions considered necessary to rectify the weaknesses.

1.3.51 The title, date and author of any project financial management report should be clearly stated and the report placed in the project’s permanent files. Supporting documentation comprises the material, documents, and working papers prepared or collected by the Financial Analyst during the assessment. Supporting documents (a) assist in the planning and performance of the assessment; (b) facilitate the supervision and review of the assessment work; and (c) record evidence resulting from the assessment performed to support the Financial Analyst’s conclusion.

1.3.52 Since the assessment relies on application of professional judgment, it is neither necessary nor practical to document every matter the Financial Analyst considers. In determining the extent of the supporting documentation to be prepared and retained, the Financial Analyst should consider what would be necessary to provide another Financial Analyst, who has had no previous experience with the assessment, with an understanding of the work performed and the principal decisions taken but not necessarily every detailed aspect of the assessment.

1.3.53 The Financial Management Assessment report will:

- Include an executive summary, with a statement of the assessment’s overall conclusion;
- Provide a brief summary of the project design;
- Describe and assess the adequacy of the financial management arrangements including disbursement arrangements;
- Identify the significant risks;
- Summarize the primary strengths and weaknesses of the financial management system, including actions required to address weaknesses;
- Identify the relevant issues to be included in the legal documents; and
- Describe the plans for supervision of the financial management aspects of the project.

1.3.54 Annex C of the FMQ (Knowledge Management, section 7.13) provides a sample format and a description of the contents of each section of the financial management assessment report. The assessment report will be written so that it can be read as a stand-alone document. It should facilitate appropriate inputs to both the financial management sections of the Appraisal Report and the project legal documents. The Report should be the minimum required to adequately describe and assess the project financial management system. The draft report should be discussed with the implementing entity and any action plans agreed with them.
1.3.55 The table below provides an outline of the assessment report with an indication of which items would typically be (a) included in the FMQ, (b) described in the assessment report, and (c) copied into the indicated section of the Appraisal Report.

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**Assuring the Quality of the Assessment**

1.3.56 The Financial Analyst’s supervisor is responsible for developing, documenting and implementing arrangements to assure that the quality of all financial management assessments performed is acceptable. Country Teams, Interdepartmental Working Groups and the Senior Management Committee will review the quality of financial management assessments as part of the Bank Group review process.
Special Purpose Entities

1.3.57 Borrowers may create new, dedicated organizational units specifically to implement Bank Group-financed projects. These units are sometimes not established, and are frequently not operational, until project preparation is well advanced. In some cases, they do not become operational before funding for the project has been approved. In these circumstances, the actual project financial management systems will not exist in the initial stages of project preparation. Nevertheless, the Financial Analyst should be engaged from an early stage of the project process, focusing initially on the proposed financial management arrangements. The Financial Analyst reviews whether the action plan prepared by the Borrower to implement the proposed arrangements is reasonable and whether sufficient capacity and resources are available to implement it. The assessment will need to be updated during project appraisal, especially before negotiations, to assess implementation progress and to determine which steps will need to be included in the legal documents (for instance, as conditions of effectiveness) to ensure that the project has adequate financial management arrangements.

Relationship with Procurement Assessments

1.3.58 All investment projects are required to have an assessment carried out of the entity’s capacity to implement procurement as part of project preparation and appraisal. Procurement forms part of the entity’s overall internal control framework. The Financial Analyst should therefore work closely with the Procurement Specialist throughout the project preparation/appraisal processes. The procurement and financial management assessments should be exchanged and discussed. The objective is to ensure that the aggregate of the two assessments provides a coherent picture of the overall control arrangements. While each assessment focuses on a different functional area, care should be taken to ensure that they are not inconsistent, and that measures proposed to mitigate risk should be mutually supportive as far as practicable.

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10 The project financial management system is the series of tasks and records of the project entity by which transactions are processed as a means of maintaining financial records. Such systems identify, assemble, analyse, calculate, classify, record, and report transactions and other events periodically presented in the financial statements.